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Financial liberalization and economic growth: A meta-analysis



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A B S T R A C T

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This study provides a systematic analysis of the empirical literature on the relationship between financial liberalization and economic growth by conducting a meta-analysis, based on 441 *t*-statistics reported in 60 empirical studies. We focus on explaining the heterogeneity of results in our sample in terms of study-, data- and method-specific characteristics. Although our findings indicate that, on average, there is a positive effect of financial liberalization on growth, the significance of this effect is only weak. Moreover, we find that most of the variables that may help explain the heterogeneity of results are insignificant. There are two exceptions. First, studies carried out based on data from the 1970s on average find a statistically less significant relationship between financial liberalization policies and growth (i.e. they report lower *t*-statistics) as compared to studies using data from the 1980s. Second, studies controlling for the level of development of the financial system report lower *t*-statistics for the relationship between liberalization and growth.

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1. Introduction

During the past two decades, many countries have reformed their domestic financial markets. These reforms were triggered by both domestic and international developments. Domestically, many government policies that focused on controlling financial markets were increasingly criticized, for it was felt that these policies impeded the efficient functioning and development of financial institutions.

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The idea that stagnating economic growth and economic crises are related to financially repressive policies has gained ground since the early 1970s (McKinnon, 1973; Shaw, 1973).¹ Moreover, the globalization of financial markets has also put pressure on governments to reconsider financial market controls. The profoundness of these reforms raises questions regarding the potential consequences of financial liberalization on economic growth.

Reforms of financial markets include several specific policies which generally aim at higher economic growth. Several authors suggest that the liberalization of financial markets raises the efficiency with which these markets can transform saving into investment, ultimately improving the growth performance of a country. At the same time, however, financial liberalization policies have been criticized for their potential role in triggering financial and economic crises. The question, therefore, is whether or not these policies lead to higher economic growth. Several survey studies have looked into this debate from an empirical point of view.² The general picture that emerges from these surveys is that the evidence remains inconclusive. However, most of these studies narrowly focus on the effects of capital account liberalization. Moreover, they do not attempt to systematically investigate the outcomes of empirical studies of the financial liberalization-growth nexus. In light of this gap, this study conducts a meta-analysis of the relationship between financial liberalization (rather than capital account liberalization only) and economic growth to provide a more systematic review of the available evidence. The analysis is based on a sample of 60 empirical studies. This is a much larger sample than has been used in any of the previous review studies.

Meta-analysis is a methodology that provides a statistical approach to reviewing and summarising the literature (Stanley, 2001). This methodology allows us to draw a comprehensive picture of the impact of financial liberalization on growth. By using meta-analysis, each study is taken as one single observation containing information on the nature of the relationship between financial liberalization and economic growth. Recently, a growing number of meta-analyses have been published in economics on issues such as the relationships between aid and growth (Doucouliagos and Paldam, 2008, 2009), central bank independence and inflation (Klomp and de Haan, 2010), investment and uncertainty (Koetse et al., 2009), economic freedom and growth (Doucouliagos and Ulubaşoğlu, 2006), democracy and growth (Doucouliagos and Ulubaşoğlu, 2008), income inequality and growth (De Dominicis et al., 2008) and fiscal policies and growth (Nijkamp and Poot, 2004). To our knowledge, this is the first study using meta-analysis as a tool to investigate the financial liberalization-growth nexus.

In our analysis, we focus on exploring the heterogeneity of findings in 60 different studies. First, we investigate whether the choice of the financial liberalization measure has an impact on the results reported in different studies. Second, we analyse the potential impact of study design. In particular, we focus on the impact of differences between studies regarding country samples, time periods, and estimation methods. Third, we explicitly focus on indirect effects of financial liberalization on economic growth. In a separate section, we also investigate whether studies suffer from a potential publication bias, i.e. whether published results provide a biased distribution of effect measures (here: *t*-statistics), because there may be a tendency not to publish results that show insignificant results.

The remainder of this study is organized as follows. Section 2 provides a review of the debate on financial liberalization and its potential effects on economic growth. In Section 3 we discuss how studies have dealt with the measurement of financial liberalization. Section 4 provides an overview of the data collection procedure and discusses the descriptive statistics. Section 5 discusses the methodology and the results of the meta-analysis in detail. The study ends with a conclusion, in which we also discuss the limitations of this review and suggestions for further research.

2. Financial liberalization and economic growth: the debate

While there may be several different characterizations of financial liberalization, in most studies financial liberalization refers to official government policies that focus on deregulating credit as well as

¹ See Fry (1995) for an overview of the discussion on financial repression.

² For surveys of the literature, see, e.g., Eichengreen (2001), Henry (2007), Kose et al. (2010), Hermes and Lensink (2008), Edison et al. (2004), and Prasad et al. (2003).

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